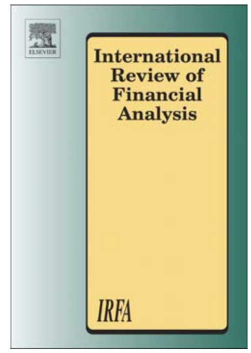
Accepted Manuscript



Funding liquidity risk and internal markets in multi-bank holding companies: Diversification or internalization?

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PII: S1057-5219(17)30217-X
DOI: doi:10.1016/j.irfa.2017.12.011
Reference: FINANA 1176

To appear in: *International Review of Financial Analysis*

Received date: 23 August 2017
Revised date: 10 December 2017
Accepted date: 28 December 2017

Please cite this article as: Ly, K.C. & Shimizu, K., Funding liquidity risk and internal markets in multi-bank holding companies: Diversification or internalization?, *International Review of Financial Analysis* (2018), doi:10.1016/j.irfa.2017.12.011

Funding liquidity risk and internal markets in multi-bank holding companies: Diversification or internalization? ☆

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Abstract

This study examines how a multi-bank holding company (MBHC) manages *funding liquidity risk* through its internal liquidity market, how its internal liquidity market works, and the benefits that its member banks enjoy. The results provide evidence that the diversification effect mostly dominates the internalization effect. A new entrant into an MBHC structure benefits from holding lower liquidity and raising deposits at lower costs than a non-MBHC structure, suggesting that MBHCs have enjoyed scant liquidity at the cost of mismatch risk. We find that other member banks also enjoy the benefits of diversified risk when a new entrant joins, suggesting that MBHCs manage liquidity in response to changes in funding liquidity risk. However, internalization is more important for MBHCs that have large numbers of subsidiaries. Whichever types of mergers/acquisitions are chosen by an MBHC, the diversification effect appears. Basel III liquidity regulations would mitigate the mismatch risk at the cost of distorted internal liquidity markets.

Keywords: funding liquidity risk, merger and acquisition, bank holding company, Basel III, Net Stable Funding Ratio

JEL classification: G21; G28; G18; G14; G32 Version 7 December 2017

☆The authors thank conference participants at the INFINITI Conference on International Finance 2017 (Spain), the Nippon Finance Association (NFA) Annual Meeting 2017, and the World Finance Conference 2017 (Italy) and seminar participants at Swansea University. We extend our appreciation to Samuel Vigne for his valuable discussion at the INFINITI Conference and to Heather Montgomery for her discussion at the NFA meeting, which resulted in the improvement of this version of the manuscript.

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